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No. 85-2087

IN THE
SUPREME COURT
OF THE UNITED STATES
October Term 1985

MILTON M. LAWRENCE and
HELEN F. LAWRENCE

Petitioners,

vs.

ADVANCED PATENT
TECHNOLOGY, Inc., et al.,

Respondents.

ON PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF
APPEALS FOR THE NINTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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19 pp

QUESTION PRESENTED

1. Whether the victim of a material omission should, as a matter of law, be taken to have relied on the person who withheld the information in an action for securities fraud under Rule 10b-5.

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Filed: March 26, 1986

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PETITION FOR WRIT OF CERTIORARI

The petitioners, Milton and Helen Lawrence, respectfully pray that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Ninth Circuit, entered in this proceeding on March 26, 1986. The respondents are: Advanced Patent Technology, a Nevada Corporation, Diversified Gaming and Technology, Inc., a Nevada Corporation, A.P.T. Financial Corporation, a Nevada Corporation, International Technical Development Corp., and Jack Solomon.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Ninth Circuit is attached hereto as Appendix A.

JURISDICTION

The judgment of the United States Court of Appeals for the Ninth Circuit, was entered on March 26, 1986 affirming judgment in the United States District Court for the District of Nevada against petitioners dated September 5, 1984. The jurisdiction of this court is invoked under 28 U.S.C. sec. 1254(1).

STATEMENT OF THE CASE

In April 1980 the SEC began a private investigation of APT with regard to its sale of unregistered stock. On May 2, 1980, APT and its president, Jack Solomon, received subpoenas from the SEC requesting documents to be used in the investigation (Appendix A, p.2). The subpoena requested 44 items. Solomon stated that it was very onerous and would take an "enormous amount of work" to comply with (RT 118-19, 162-64).

Thereafter, on May 16 and June 30, 1980, the Lawrences bought 50,000 restricted shares of stock in APT from Solomon. Solomon failed to inform the Lawrences of the investigation during the negotiations for the sale (Appendix A, p.2). He explained this lapse at trial with the statement, "I guess I just didn't think it was important (RT 165)."

On July 2, 1980, APT issued a press release describing the investigation. The Wall Street Journal of July 3, 1980 then published an article on the investigation (Plaintiffs'

Excerpt of the Record, p. 34, hereinafter ER). When the Lawrences first learned of this, in August of 1980, they made several efforts to rescind the sale, but to no avail (RT 68-73).

In its annual report for 1980, APT admitted that its actions in previous years "may have constituted violations of the registration and anti-fraud provisions of Federal and state securities laws." (Ex. 2).

On March 24, 1981, the National Association of Security Dealers de-listed APT stock. On March 30, 1981, the SEC suspended trading in it (ER 5). Having held the stock for the two years required by law, the Lawrences sold it in June 1982, incurring a loss of $122,500 (Appendix, p.2).

The Lawrences filed suit for fraud and violation of Rule 10b-5 in July 29, 1982. In its decision of September 5, 1984, the District Court entered judgment for defendants, "holding, inter alia, that the Lawrences had not relied on what Mr. Solomon said or did not say" (Appendix, p.2).

The Court of Appeals affirmed, holding that the presumption that the Lawrences relied on Solomon's omission had been rebutted. In the Court of Appeals' view, the presumption of reliance was rebutted by a showing that the Lawrences would have bought even if they had known about the investigation (Appendix, p.2-3).

REASONS FOR GRANTING THE WRIT

THE DECISION BELOW RAISES THE SIGNIFICANT AND RECURRING PROBLEM OF WHETHER A SHOWING OF A MATERIAL OMISSION IN AN ACTION UNDER 10B-5 ESTABLISHES RELIANCE BY THE PLAINTIFF AS A MATTER OF LAW, OR INSTEAD ESTABLISHES ONLY A REBUTTABLE PRESUMPTION OF RELIANCE.

This Court held in *Affiliated Ute Citizens v. United States*, 406 U.S. 128 (1972) that, in actions under section 10b-5 for failure to disclose information to investors,

> [P]ositive proof of reliance is not a prerequisite to recovery. All that is necessary is that the facts withheld be material in the sense that a reasonable investor might have considered them important in the making of this decision. . . . This obligation to disclose and this withholding of a material fact establish the requisite element of causation in fact.
>
> 406 U.S. at 153-54

This language clearly establishes that the plaintiff does not have the burden of proving reliance where materiality has been shown; it leaves open the question of whether a defendant responsible for a material omission can stave off liability for it by showing that the plaintiff, though deprived of material information, was not in any case relying on the defendant to make full disclosure to him.

There are two schools of thought on this issue. One, represented by the Ninth Circuit opinion on which Court of Appeals here relied *(Kiernan v. Homeland Inc.*, 611 F.2d

785 at 789 (1980)), holds that a showing of materiality establishes only a *presumption* of reliance, rebuttable if defendant shows that "plaintiff . . . would not have attached significance to the omitted facts, and therefore would have acted as he did if he had known the truth."

On the other hand, there is the view espoused by Judges Mansfield and Lumbard of the Second Circuit Court of Appeals. That view, originally stated by Judge Mansfield in his concurring and dissenting opinion in *Chris-Craft Industries v. Piper Aircraft Corp.*, 480 F.2d 341, 399- 400 (1973), rejects the "presumption" of reliance and takes the teaching of this Court in *UTE Citizens* to be that reliance is established "as a matter of law" once the materiality of an omission has been shown. Judge Lumbard, endorsing Judge Mansfield's view in *Herbst v. IT&T*, 495 F.2d 1308, 1316, footnote 14 (1974), pointed out that neither in *UTE* nor in its predecessor *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375 (1970), had this Court "remanded . . . for the purpose of allowing defendants to raise a defense" after finding materiality. See also *Tucker v. Arthur Andersen 67 F.R.D.*, 468 at 479, footnote 19 (1975).

This Court should now affirm the Mansfield-Lumbard approach as essential to the achievement of the purposes of the Security and Exchange Act of 1934, and to the rules established under it.

> As this Court has already held, these laws
>
> embrace a "fundamental purpose . . . to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* and thus to achieve a high standard of business ethics in the securities industry." *SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 186 . . . (1963) . . . . Congress intended securities legislation enacted for the

> purpose of avoiding frauds to be construed "not technically and restrictively, but flexibly to effectuate its remedial purposes."
>
> *Affiliated Ute Citizens v. United States*, 406 at 151, *supra*.

This philosophy can be made effective only by assuring sellers that they will be held to account for withholding material information from any investor, however sophisticated or unsophisticated they might believe that investor to be. *See TSC Industries Inc., v. Northway Inc.*, 426 U.S. 438, 449 (1976); Jacobs, *Litigation and Practice Under Rule 10b-5*, Section 61.02 (second ed., rev., 1985).

In the words of the Second Circuit Court of Appeals, Rule 10b-5 is

> founded on the principle that full and fair disclosure of all material facts must be made to investors so that they may have the benefit of the facts in making their investment decisions.
>
> *Sonesta International Hotels Corp. v. Wellington Assoc.*, 483 F.2d 247 at 249 (1973).

If sellers are assured that they cannot be held liable to investors they can show to be particularly sophisticated or skeptical, the deterrent force of the law will be severely diluted. Crucially, the effectiveness of this body of law depends upon ensuring that sellers must always take full responsibility for their conduct:

> The obligation is placed squarely on those making the offer in the first instance to disclose all material factors necessary to make their offer not misleading. That duty cannot be shifted to the shoulders of others.

Sonesta International Hotels Corp. v. Wellington Assoc., 483 F.2d 247 at 255 *supra.*

To allow this presumption of reliance to be rebutted is precisely to shift the duty from the shoulders of the sellers to those of investors. This amounts to the adoption of a subjective, rather than objective, standard of materiality, contrary to the decisions of this court. *See TSC v. Northway Inc.*, 426 U.S. 438, 449, *supra;* Jacobs, para. 61.02(b)(ii), 3-131. It gives the seller an opportunity to divert attention from his own wrongdoing by making the subjective state of mind of the investor the center of attention.

Such an approach "emasculate[s]" the purposes of the law, resulting in a virtual "nullification of the disclosure requirements of the act." *Sonesta International Hotels Corp. v. Wellington Assoc.*, 483 F.2d 247 at 255, *supra.* This consequence is apparent here. By giving the defendants the opportunity to disprove reliance, the trial court allowed Jack Solomon to distract it from the undisputed fact that Solomon consciously withheld relevant information from the Lawrences, information which, only a short time later, was important enough to publish in the Wall Street Journal (RT 165, ER 34).

Instead, the court focussed on evidence showing that Milton Lawrence was an "expert" in the law of restricted stock (ER 31-32, para. 8), that the Lawrences understood the risk they were taking in buying this stock (ER 32, para. 9), and that the Lawrences knew that Jack Solomon exaggerated and neither believed or relied upon anything he said (ER 33-34, paras. 11, 12, 15).

The irony of allowing such evidence to rebut reliance, and defeat liability, is particularly clear here. Because it was being looked at, not from the objective perspective of the public interest in full disclosure, but from the Lawrences'

supposed subjective point of view, the evidence of Jack Solomon's untrustworthy character was a positive asset to him, not the deficit it should have been.

Thus, as was to be expected from this approach, the victimized investors were put on trial in place of the seller who victimized them. The trial court found reliance to be refuted, in spite of the fact that Milton Lawrence made strenuous efforts to rescind the purchase as soon as he learned of the information which had been withheld from him (RT 68-73). Unable to rescind, the Lawrences were compelled to hold onto the stock for two years, the period required by law before restricted stock can be resold. Then, as soon as the law allowed, they sold the stock, at a nearly total loss (Appendix, p.2). The seller has now been allowed to profit from his wrongdoing, and the investors are without a remedy for their loss.

This case is, then, a perfect example of how securities legislation can be "emasculated" by allowing defendants to shift attention from their own conduct to that of the investors. Such emasculation must not be tolerated by this Court. It can be avoided through the adoption of the approach championed by Judges Mansfield and Lumbard: once it has been established that a seller of securities has withheld objectively material information from investors, the investors' reliance must be taken to be established *as a matter of law.* It must be made clear to the sellers of securities that they will be given no chance to avoid their responsibility for full disclosure. *Chris-Craft Industries, Inc. v. Piper Aircraft Corp.*, 480 F.2d 341, 399-400, *supra; Herbst v. IT&T*, 495 F.2d 1308, 1316, footnote 14, *supra, Cf., Lewis v. Walston & Co. Inc.*, 487 F.2d 617 (1973).

There are many thousands of investors like the Lawrences. In fact, there are many others around the

country who, like them, invested in APT restricted stock. By firmly establishing the doctrine that reliance cannot be rebutted, this Court can ensure that these investors will have a remedy for past wrongs, and that insiders will not be tempted to victimize them again in the future.

CONCLUSION

For these reasons, the petition for writ of certiorari should be granted.

Respectfully submitted,

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